

The GIBSON&PERKINS Tax Letter

CIRCULATED TO TAX ADVISORS AND CLIENTS

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AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009

On February 17, 2009, the President signed the American Recovery and Reinvestment Act of 2009 into law. The \$787 billion new law is summarized below.

INDIVIDUAL INCENTIVES

Making Work Pay Credit

The new law provides an individual tax credit in the amount of 6.2 percent of earned income not to exceed \$400 for single returns and \$800 for joint returns in 2009 and 2010. The credit is phased out at a two percent rate if adjusted gross income (AGI) is in excess of \$75,000 (\$150,000 for married couples filing jointly). The credit is applied retroactively to the start of 2009 and will be repeated again in 2010. It can be claimed as a reduction in the amount of income tax that is withheld from a paycheck, or through a credit on a tax return.

Earnings from self-employment also qualify to the extent that they are taken into account when computing taxable income. Individuals who do not provide a Social Security number on their returns are ineligible. Under the credit, workers can expect to see perhaps \$13 a week less withheld from their paychecks starting around June. Next year, the extra take-home pay will go down to around \$9 per week.

Only individuals with earned income would qualify for the Making Pay Credit, which would effectively offset an individual's share of FICA payroll taxes for the first \$6,542 in earnings (\$12,904 for couples). The employer's share of FICA, or its 6.2 percent equivalent to be more precise, would remain unchanged.

\$250 Economic Recovery Payment

The new law provides for a one-time payment of \$250 – for 2009 only - to individuals on fixed income – primarily retirees, disabled individuals, Social Security beneficiaries and SSI recipients receiving benefits from the Social Security Administration, Railroad Retirement beneficiaries, and to veterans receiving disability compensation and pension benefits from the U.S. Department of Veterans' Affairs. The one-time payment is a reduction to any allowable Making Work Pay credit. The logistics for distribution of the checks has not been announced.

AMT Patch

To hold the number of taxpayers subject to the AMT at bay, the new law increases the AMT exemption amounts for 2009 to \$46,700 for individuals and \$70,950 for joint returns, and

allows the personal credits against the AMT. The patch is designed to insulate approximately 26 million middle income taxpayers from the reach of the AMT.

First Time Homebuyer Credit

Last year, Congress provided taxpayers with a refundable tax credit that was equivalent to an interest-free loan equal to 10% of the purchase of a home (up to \$75,000) by first-time home buyers. The provision applied to homes purchased on or after April 9, 2008 and before July 1, 2009. Taxpayers receiving this tax credit were required to repay any amount received under this provision back to the government over 15 years in equal installments (or earlier if the home was sold). The credit phases out for taxpayers with adjusted gross income in excess of \$75,000 (\$150,000 in the case of a joint return). The new law enhances the credit by eliminating the repayment obligation for taxpayers that purchase homes on or after January 1, 2009. It also extends the credit through the end of November 2009, and bumps up the maximum value of the credit from \$7,500 to \$8,000.

The effective date for the new laws no-pay back provisions is keyed to “*residences purchased after December 31, 2008.*” A purchase takes place when title closes rather than when the contract is executed.

New Car Deduction

The new law allows taxpayers to deduct State and local sales taxes paid on the purchase of a new automobile, including light trucks, SUVs, motorcycles, and motor homes. The tax break phases out starting with taxpayers earning \$125,000 per year (\$250,000 for joint returns). The deduction is allowed to both those who itemize their deductions and non-itemizers as well. However, the deduction cannot be taken by a taxpayer who elects to deduct State and local sales taxes in lieu of State and local income taxes.

Sales tax is generally not a deductible item for individuals. A limited exception allows taxpayers who itemize their deductions to claim either state or local income taxes or state and local general sales taxes, which mainly benefits taxpayers with a state or local sales tax but no income tax. Under the new law, buyers can claim an income tax deduction for the sales or excise tax they pay on a vehicle purchase. Key details of this new tax incentive include:

- > The tax break applies to purchases of passenger cars, minivans, light trucks, motorcycles, and motor homes, but it only applies on \$49,500 of the vehicle's price and it only applies to new vehicles.
- > The tax break covers new vehicles purchased between the date of enactment of the 2009 economic stimulus legislation and the end of 2009.
- > You do not have to itemize your deductions to be able to claim the deduction. However, the deduction cannot be taken by a taxpayer who elects to deduct state and local sales taxes in lieu of state and local income taxes.

- > Only couples making having adjusted gross income of less than \$250,000 a year, or individuals with less than \$125,000 annually, qualify for the full deduction. Any deduction is phased out above those levels of AGI.
- > Both domestic and foreign-made vehicles qualify.
- > The new car deduction is effective only for vehicle purchases after February 16, 2009.

Education Credit

The new provision temporarily enlarges the Hope Tax Credit (renamed the “American Opportunity Tax Credit”) for students from middle-income families and partially extends this tax credit for the first time to students from lower-income families. Here are the details.

- > The new law creates a new American Opportunity Tax Credit for 2009 and 2010, replacing and expanding the Hope Tax Credit for those years.
- > The maximum amount of the American Opportunity Tax Credit is \$2,500 (up from a maximum credit of \$1,800 under the Hope Credit). The credit is 100% of the first \$2,000 of qualifying expenses and 25% of the next \$2,000, so the maximum credit of \$2,500 is reached when a student has qualifying expenses of \$4,000 or more.
- > While the Hope credit was only available for the first two years of undergraduate education, the American Opportunity Tax Credit is available for up to four years.
- > Under the Hope Credit, qualifying expenses were narrowly defined to include just tuition and fees required for the student's enrollment. Textbooks were excluded, despite their escalating cost in recent years. The American Opportunity Tax Credit expands the list of qualifying expenses to include textbooks.
- > The Hope Credit was nonrefundable, i.e., it could reduce your regular tax bill to zero but could not result in a refund. This meant that if a family didn't owe any taxes it couldn't benefit from the credit, which prompted critics to argue that the credit was thus denied to the very families most in need of help affording college. The American Opportunity Tax Credit addresses this criticism to a degree by providing that 40% of the credit is refundable. This means that someone who has at least \$4,000 in qualified expenses and who would thus qualify for the maximum credit of \$2,500, but who has no tax liability to offset that credit against, would qualify for a \$1,000 (40% of \$2,500) refund from the government.

The Hope Credit was not available to someone with higher than moderate income. Under the credit's “phaseout” provision, taxpayers with adjusted gross income (AGI) over \$50,000 (for

2009) saw their credits reduced, and the credit was completely eliminated for AGIs over \$60,000 (twice those amounts for joint filers). Under the American Opportunity Tax Credit, taxpayers with somewhat higher incomes can qualify, as the phaseout of the credit begins at AGI in excess of \$80,000 (\$160,000 for joint filers).

Child Tax Credit

The new law increases the refundable portion of the child tax credit for 2009 and 2010 by lowering the threshold to \$3,000 (from \$8,500 in 2008).

Unemployment Compensation

A provision temporarily suspends federal income tax on the first \$2,400 of unemployment benefits received by a recipient in 2009.

Transit Benefits Parity

Qualified transportation fringe benefits such as transit passes, van pooling and qualified parking, are not included in an employee's income up to a specified dollar amount. The new law increases the current \$120 per month exclusion amount for transit passes and van pooling for \$230 per month for 2009 (starting in March) and continues it through 2010 with an inflation adjustment.

Qualified Tuition Programs

Distributions from Qualified Tuition Programs (also known as Sec. 529 Plans) are tax free if used to pay plan beneficiaries qualified education expenses. Other distributions are included in the beneficiary's income and subject to penalty. For 2009 and 2010, the new law allows beneficiaries of qualified tuition programs to use tax-free distributions to pay for computers and computer technology, including Internet access.

BUSINESS INCENTIVES

Bonus Depreciation

Last year, Congress temporarily allowed business to recover the costs of capital expenditures made in 2008 faster than the ordinary depreciation schedule would allow by permitting these businesses to immediately write off 50% of the cost of depreciable property acquired in 2008 for use in the United States. The new law extends this temporary benefit for qualifying property purchased and placed into service in 2009.

50-percent bonus depreciation is taken on top of the regular depreciation reported for the year the property is placed in service. As with any accelerated depreciation however a large current depreciation deduction results in smaller future deductions.

NOL Carry back

Under pre-Act law, net operating losses (NOLs) may be carried back to the two years before the year that the loss arises and carried forward to each of the succeeding twenty years after the year that the loss arises. The new law extends the maximum NOL carryback period from two years to five years for small businesses with gross receipts of \$15 million or less for any tax year beginning or ending in 2008. The normal carryback period which is two years for all businesses returns for NOLs incurred in 2009.

Work Opportunity Tax Credit

Businesses are allowed to claim a work opportunity tax credit equal to 40% of the first \$6,000 of wages paid to employees of one of nine targeted groups. The new law expands the work opportunity tax credit to include two new targeted groups: (1) “unemployed veterans”; and (2) “disconnected youth.” These new categories apply to individuals who are hired and begin work in 2009 or 2010.

Individuals qualify as “unemployed veterans” if they were discharged or released from active duty from the Armed Forces during 2008, 2009 or 2010 and received unemployment compensation for more than four weeks during the year before being hired. Individuals qualify as “disconnected youths” if they are between the ages of 16 and 25 and have not been regularly employed or attended school in the past 6 months.

Refundable Credit in Lieu of Bonus Depreciation

In order to help small businesses quickly recover the cost of certain capital expenses, small business taxpayers may elect to write off the cost of the expenses in the year of acquisition in lieu of recovering these costs over time through depreciation. Last year, Congress temporarily increased the amount that small businesses could write off for capital expenditures incurred in 2008 to \$250,000 and increased the phase-out threshold for 2008 to \$800,000. The new law extends these temporary increases for capital expenditures incurred in 2009.

Cancellation of Indebtedness

To benefit certain businesses that buy their own debt at a discount, the new law lets the businesses recognize cancellation of debt income (“CODI”) over 10 years (defer tax on CODI for the first four or five years and recognize this income ratably over the following five tax years) for specified types of business debt repurchased by the business in 2009 or 2010.

Qualified Small Business Stock

The new law increases the exclusion for gain from the sale of certain small business stock held for more than five years from 50% to 75% for stock issued after the enactment date and before 2011.

S Corp Built-in Gain Period

The new law temporarily shortens the holding period of assets subject to the built-in gains tax from 10 years to seven years.

NOL Limitations on Banks Reinstated

The new law provides a prospective repeal of Notice 2008-83, the controversial IRS guidance which provided that if a bank recognizes a loss from the disposition of a loan or takes a bad debt deduction under the specific charge-off or reserve methods of accounting after a change in ownership, that loss or deduction will not be treated as a built in loss attributable to the pre-acquisition period.

New Markets

The new law increases the New Markets Tax Credit ("NMTC") program authorizing allocations of \$5 billion for 2008 and 2009.

COBRA Benefits

The new law allows an individual who is involuntarily separated from employment between September 1, 2008 and January 1, 2010, to elect to pay 35 percent of his or her COBRA coverage and have it treated as paying the full amount.

The former employer will be required to pay the remaining 65 percent but, in effect, will be reimbursed by crediting those amounts against income tax withholding and payroll taxes it is otherwise required to remit to the federal government.

ENERGY INCENTIVES

Residential Energy Property Credit

The new law increases the Code Sec. 25C residential energy property tax credit from 10 percent to 30 percent, raised the maximum cap to a \$1,500 aggregate amount for 2009 and 2010 installations, eliminates the \$500 lifetime cap, and makes several other modifications. The changes are effective for eligible property placed in service after December 31, 2008, and before January 1, 2011.

Residential Energy Efficient Property Credit

The new law removes the individual dollar caps under the Code Sec. 25D residential energy efficient property credit for solar hot water property, geothermal heat pumps and wind energy property. The new law, however, does place a \$500 credit cap on qualified fuel cell property expenditures.

Alternative Fuel Pump Tax Credit

The new law increases the credit for alternative fuel vehicle refueling property for commercial and retail refueling stations for 2009 and 2010. The credit currently equals 30 percent of the cost of property placed in service at each location by the taxpayer during the tax year but is limited to \$30,000. The agreement increases the credit to 50 percent (capped at \$50,000) for property placed in service in 2009 and 2010. For individuals, the credit is also

increased to 50 percent (capped at \$2,000).

Renewable Electricity Production Credit

Code Sec. 45 provides a credit for electricity produced from renewable sources, such as wind. The new law extends (generally, through 2013; through 2012 for wind facilities) the placed-in-service dates for qualified wind and other facilities under Code Sec. 45.

Energy Investment Credit

The Economic Stimulus Act expanded the Code Sec. 48 energy investment credit to include qualified small wind energy property. The new law removes the credit cap for qualified small wind energy property. A 30 percent credit presently is available for qualified small wind energy property expenses made by the taxpayer during the tax year.

Investment Credit Election

In lieu of producers taking the Code Sec. 45 production tax credit, the new law allows taxpayers to treat certain qualified alternative energy facilities as energy property eligible for a 30 percent investment credit under Code Sec. 48. Code Sec. 45 provides a credit for the production of electricity from alternative sources of energy at qualified facilities. The agreement limits the election for wind property placed in service in 2009-2012 and for other property placed in service in 2009-2013. The new law also coordinates Code Sec. 48 with renewable energy grants.

Plug-in Electric Vehicles

Although plug-in electric vehicles are not yet on the market, the new law modifies the existing credit for these environmentally-friendly vehicles. Separate treatment has also been carved out for low-speed vehicles. The base amount of the credit for qualified plug-in electric vehicles is

Regards,

A handwritten signature in black ink, appearing to read 'Ted Perkins', with a long horizontal flourish extending to the right.

Ted Perkins

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